97TH CONGRESS
2d Session

COMMITTEE PRINT

REPORT

OF THE

TEMPORARY SUBCOMMITTEE ON FEDERAL CREDIT

TO THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

DECEMBER 1982

Printed for the use of the Committee on the Budget

U.S. GOVERNMENT PRINTING OFFICE
12-819 O WASHINGTON : 1982

5252-1

COMMITTEE ON THE BUDGET

PETE V. DOMENICI, New Mexico, *Chairman*

WILLIAM L. ARMSTRONG, Colorado	ERNEST F. HOLLINGS, South Carolina
NANCY LANDON KASSEBAUM, Kansas	LAWTON CHILES, Florida
RUDY BOSCHWITZ, Minnesota	JOSEPH R. BIDEN, JR., Delaware
ORRIN G. HATCH, Utah	J. BENNETT JOHNSTON, Louisiana
JOHN TOWER, Texas	JIM SASSER, Tennessee
MARK ANDREWS, North Dakota	GARY HART, Colorado
STEVEN D. SYMMS, Idaho	HOWARD M. METZENBAUM, Ohio
CHARLES GRASSLEY, Iowa	DONALD W. RIEGLE, JR., Michigan
ROBERT W. KASTEN, Wisconsin	DANIEL PATRICK MOYNIHAN, New York
DAN QUAYLE, Indiana	J. JAMES EXON, Nebraska
SLADE GORTON, Washington	

STEPHEN BELL, *Staff Director*
LIZABETH TANKERSLEY, *Minority Staff Director*
W. THOMAS FOXWELL, *Director of Publications*

TEMPORARY SUBCOMMITTEE ON FEDERAL CREDIT

SLADE GORTON, Washington, *Chairman*

WILLIAM L. ARMSTRONG, Colorado	HOWARD M. METZENBAUM, Ohio
RUDY BOSCHWITZ, Minnesota	JIM SASSER, Tennessee
ROBERT W. KASTEN, Wisconsin	DANIEL PATRICK MOYNIHAN, New York

LETTER OF TRANSMITTAL

To the Committee Members:

The Temporary Subcommittee on Federal Credit was formed with the mandate to investigate and report on the budgetary effects of Federal credit activities. We transmit this report to the full committee pursuant to our directions and hereby conclude the work of the temporary subcommittee.

The scope of our investigation, our findings, and recommendations are attached. Our recommendations include adoption of legislation formally to incorporate Federal credit activities into the Congressional Budget Act. We urge the full committee to begin consideration of our recommendations at the earliest possible date.

Slade Gorton, *Chairman.*
Rudy Boschwitz.
Robert W. Kasten.
Howard M. Metzenbaum.
Jim Sasser.
Daniel Patrick Moynihan.

CONTENTS

	Page
LETTER OF TRANSMITTAL	III
INTRODUCTION	VII
SUMMARY	IX
Chapter I. SCOPE OF THE SUBCOMMITTEE	1
Secondary Guarantees	2
Government-Sponsored Enterprises	3
Private-Purpose Tax-Exempt Debt	3
Chapter II. HISTORY OF FEDERAL CREDIT ACTIVITIES	5
Expansion of Federal Credit Assistance	5
Housing Credit Assistance	6
Government-Sponsored Enterprises	7
Establishment of the Federal Financing Bank	7
Chapter III. FINDINGS OF THE SUBCOMMITTEE	9
Budgetary Treatment of Federal Credit	9
Off-Budget Spending	11
Revolving Funds	12
Loan Asset Sales	14
FFB Conversion of Loan Guarantees to Direct Loans	15
Loan Guarantees	16
Budgetary Control of Federal Credit	17
Loan Guarantees	18
Direct Loans	18
Credit Control System	20
Congressional Action on Control of Credit	21
Executive Reporting of Actual Credit Activity	21
Revisions of Annual Activity Levels	22
Subsidies	23
FFB Loans	24
Total Subsidies Provided	24
Defaults	24
Role of the Federal Financing Bank	25
Chapter IV. RECOMMENDATIONS OF THE SUBCOMMITTEE	27
Congressional Consideration of Credit	27
Treatment of Defaults	28
Impoundment Control	28
Reporting of Actual Credit Activity	28
Other Recommendations	28

INTRODUCTION

The Budget Committee is required by Section 703 of the Budget Act to study and report to Congress methods which will improve the congressional budget process. The size, complexity, and diversity of the Nation and of the people and interests represented in the institution of Congress is reflected in congressional policies and actions. No individual or interest exists in isolation, however, and no decision can be responsibly viewed in isolation. All congressional decisions involving the use of the Nation's economic resources must be viewed in a framework recognizing the reality of limitations and reflecting the sum of individual decisions so that they may be examined as to their total effect.

The congressional control over the Nation's resources exerts substantial impact on the economy of the United States and, therefore, on the lives of its citizens. The right to exert this influence carries with it the obligation to see that such actions be taken in a responsible fashion. It is this obligation which resulted in the creation of the congressional budget process and which demands that Congress constantly improve that process to achieve its purpose.

If the budget process omits, for whatever reason, congressional actions which affect certain economic resources of the Nation, the process is deficient. The Budget Committee shares the concerns of many that congressional policies and actions designed to provide assistance in obtaining or affording credit are not adequately considered in the budget process.

During the 96th Congress, the Senate Budget Committee established a Special Subcommittee on Control of Federal Credit. The work of the subcommittee was concluded and its findings were transmitted to the full committee for consideration during deliberation on the First Concurrent Resolution for Fiscal Year 1982. The subcommittee recommended continued efforts in the area of Federal credit and the creation of a similar oversight body within the Senate Budget Committee of the 97th Congress.

As a result of the committee's continued concerns about Federal credit activities, the chairman established a Temporary Subcommittee on Federal Credit in November 1981. The subcommittee was charged with investigating and reporting on:

—the relationship between Federal credit activity and the congressional budget process, the unified budget, and the deficit;
—proposed legislation before the committee addressing Federal credit; and
—congressional control mechanisms.

Over the course of several months, the subcommittee held four hearings and received testimony from 23 witnesses representing the executive and legislative branches of the Federal Government,

the Federal Reserve Board, the business and financial communities, and program beneficiaries. The staff conducted research and investigation of issues raised during the proceedings. A study and report on the Federal Financing Bank (FFB) was requested by the subcommittee of the Congressional Budget Office and was released in January 1982. The subcommittee also requested of the General Accounting Office a comprehensive listing of Federal direct loan and loan guarantee programs, insurance reserves, delinquency status, and incidence of default. The subcommittee has been informed that work is in progress on that project and a report will be published shortly.

Following is the report of the temporary subcommittee to the full Budget Committee. A summary of the scope, findings, and recommendations of the temporary subcommittee precedes a more detailed discussion.

SUMMARY

Scope of the Subcommittee

- The report of the subcommittee addresses only those Federal credit activities subject to the control of Congress and whose annual activity level can be measured within the existing budget framework. Further, the report addresses Federal credit activity in the aggregate. Specific credit programs are not addressed, nor does the report address the use of Federal credit assistance as a technique to achieve policy objectives.
- The report addresses two broad categories of Federal credit assistance within these parameters: direct Federal loans and Federal loan guarantees.
- The subcommittee has excluded Government-sponsored enterprises from its recommendations in recognition of their independent status. However, the subcommittee urges further investigation into the structure and economic effects of Government-sponsored enterprises.
- The subcommittee defers private-purpose tax-exempt debt from its recommendations as this type of assistance is more properly classified as a tax expenditure. The subcommittee favors investigation by the full committee of the relationship between the congressional budget process and tax expenditures.

Findings of the Subcommittee

- The budgetary treatment of Federal direct loans and loan guarantees is incomplete in the context of a unified budget. The methods used to account for direct loans and loan guarantees understate the true level of credit activity.
- Since most Federal credit activities are not included in the unified budget, the true size and scope of Federal spending and Federal borrowing requirements are not adequately reflected in the budget totals.
- The function of the Federal Financing Bank (FFB) as a debt management tool is valid. However, the budgetary treatment of the budget authority and outlays resulting from the operations of the FFB should be modified to allow activity to be attributed to the agency initiating the use of budget resources.
- Existing rescission and deferral procedures do not allow control over annual credit levels, and should be expanded to accommodate changes in credit activities.
- The present system for reporting the actual program levels of Federal credit activity for the fiscal year to date by the executive

branch is inadequate to enable Congress to determine Federal policy.

RECOMMENDATIONS OF THE SUBCOMMITTEE

- Federal direct loans and loan guarantees should be permanently integrated into the congressional budget process and represented in a manner consistent with Federal expenditures.
- Congress should adopt legislation which attributes the budget authority and outlays of the Federal Financing Bank to the agency effecting the credit transaction.
- The executive branch should report to Congress on a periodic basis throughout the fiscal year on the actual level of direct loan obligations and loan guarantee commitments for that fiscal year to date.
- Information on the incidence of defaults should be provided in a more comprehensive and standard manner that allows Congress adequately to evaluate programs and meet its oversight responsibilities. The treatment of defaulted loan guarantees as new direct loans should be ended.
- Further investigation leading to better understanding of the economic effects of Federal credit activity should be initiated by Congress and the executive branch.

Chapter I. SCOPE OF THE SUBCOMMITTEE

Any program, policy, or regulation of the Federal Government that reallocates available credit to a mix of borrowers different than that which would result from the operations of the market is properly classified as a form of Federal credit assistance. Similarly, any borrower who, by virtue of a Federal policy, is able to obtain credit on terms—interest rate, maturity, loan-to-value ratio, etc.—different than that which would result from private negotiations between the borrower and lender in the absence of a Federal presence is benefiting from a form of Federal credit assistance.

Credit assistance can range from the explicit to the indirect with a corresponding variation of visibility in the budget. The Federal budget, in its current form, measures Federal activity in terms of authority to incur Federal obligations, Federal dollars expended, and revenues collected. These concepts are labeled budget authority, outlays, and revenues, respectively. This system of measurement precludes inclusion of many activities which accomplish legislative goals but do so through methods other than the collection of a tax dollar or an expenditure from the Treasury. For example, a change in a Federal regulation may have an economic or behavioral impact identical to a change in Federal spending. The latter will be reflected in the Federal budget; the former will not.

The existing Federal budget has the limitations of any document constructed of homogeneous, quantifiable terms; activity that cannot be measured by those terms cannot be easily encompassed. Accordingly, the budget process cannot encompass all forms of Federal credit assistance, as it cannot cover all forms of Federal activity that affect the Nation's economy.

In light of this limitation, the report of the subcommittee addresses only those activities which are subject to the direct control of Congress and whose annual activity level can be measured within the existing budget framework. Two broad categories of Federal credit assistance fall within these parameters: direct Federal loans and Federal loan guarantees.

Direct Federal loans are the transfer of funds by a Federal agency to non-Federal recipients under an agreement that obligates the borrower to repay the funds to the Federal Government.

Direct loans are made by the agencies and departments of the Federal Government pursuant to authority granted by Congress. The Office of Management and Budget has identified approximately 204 programs explicitly authorized to make direct loans that achieve policy objectives in 15 of the 19 functional categories of the budget. The Federal Government entered into obligations to make new direct loans totaling $57.2 billion in fiscal year 1981.

Federal loan guarantees are agreements in which a Federal agency enters into a firm commitment to use Federal funds as necessary to secure a non-Federal lender, either fully or partially, against default on the part of a non-Federal borrower.

The Office of Management and Budget has identified approximately 150 programs that are authorized to provide loan guarantees. Eleven of the 19 functional categories of the budget include guarantee programs to achieve the policy objective of that category. In fiscal year 1981, the Federal Government entered into commitments to provide loan guarantees totaling $76.5 billion.

Implicit in the definition of Federal loan guarantees is the exclusion of transactions between Federal agencies. If a transaction between Federal agencies merely rearranges the servicing or stewardship of a loan, there is no net impact on the economy and the transaction would cloud the aggregate display of Federal credit if it were included in the budget. A transaction which results in a new extension of credit within the economy, however, in whatever form, should not be excluded from budget totals even if that transaction involves one or more intergovernmental transactions during the process.

Those transactions that fall within the definition of a loan guarantee and involve all the parties of a guarantee—a non-Federal borrower, a non-Federal lender, and the Federal Government as guarantor—are termed *primary guarantees.*

Secondary Guarantees

A different form of loan guarantee, still within the broad category of Federal guarantees, is used to promote a secondary market for specific types of loans. A secondary market allows an original lender to resell his financial asset—a loan agreement—to an investor willing to invest in loans but unwilling or unable to deal with a large number of small borrowers. These investors may also desire a certain degree of liquidity in their portfolio, which requires that the investment be in the form of a fairly standardized security. An active secondary market for a particular type of loan attracts more investors and, therefore, a greater amount of lendable funds is made available to a particular group of borrowers.

The largest Federal program involved in promoting a secondary market is the mortgage-backed securities (MBS) program conducted by the Government National Mortgage Association (GNMA or "Ginnie Mae"). GNMA guarantees timely payment of securities that represent a claim on many smaller mortgages previously guaranteed by either the Federal Housing Administration (FHA) or the Veterans' Administration (VA).

Thus, a homebuyer will obtain a mortgage guaranteed by FHA or VA, that mortgage will be included with other mortgages into a pool, and securities guaranteed by GNMA representing ownership in the pool are sold in the financial market. All homebuyers included in the pool make their monthly principal and interest payments to a servicing organization which in turn transmits payment to the holder of the MBS.

In essence, this is simply one relationship between a borrower (homebuyer) and a lender (MBS investor). However, two securities

are involved with two guarantees of payment: a mortgage guaranteed by FHA or VA and an MBS guaranteed by GNMA. The GNMA guarantee is designated as a "secondary guarantee" to emphasize the fact that only one extension of credit has occurred.

Government-Sponsored Enterprises

Several Government-sponsored enterprises pursue their mandated goals by means of credit assistance, including direct lending and the establishment of secondary markets. Government-sponsored enterprises, while federally chartered and sponsored, are privately owned and designed to operate independently of Congress. The subcommittee has excluded these entities from its recommendations in recognition of their independent status and of the fact that their obligations are not legally backed by the full faith and credit of the U.S. Government. The subcommittee has received a great deal of evidence, however, suggesting that Government-sponsored enterprises are perceived by the financial markets to be the same as Federal agencies by virtue of their affiliation with the Federal Government and apparently due to the assumption that Federal assistance would be provided if the need arose.

Because the evidence is not conclusive, the subcommittee urges further investigation into the structure and economic effects of Government-sponsored enterprises.

Private-Purpose Tax-Exempt Debt

Section 103 of the Internal Revenue Code of 1954 provides that interest income earned on bonds issued by State and local authorities shall not be taxable. Investors (lenders) will accept a lower rate of interest on securities issued under this provision than they would on securities whose interest payments constitute taxable income. Thus, beneficiaries of tax-exempt debt enjoy a competitive advantage over all borrowers merely by virtue of this congressional tax policy.

State and local authorities have traditionally used tax-exempt debt to finance capital projects which expand or improve the infrastructure of their jurisdiction or for other public purposes administered by the governing body. In recent years, however, tax-exempt debt has been used for a wider variety of purposes including private hospitals, student loans, pollution control, mortgage revenue bonds that provide low interest mortgages for owner occupied and rental housing, and industrial development bonds (IDBs).

IDBs are issued by private borrowers to a lending institution or investor through a State or local authority. Using a State or local authority as a broker or middleman allows the bonds to pick up tax-exempt status—and a lower interest rate—but does not impose responsibility on the authority to guarantee repayment of interest and principal in the event of default.

To the extent that the tax-exempt provisions of the tax law are used to finance private activities, congressional policy objectives are being achieved through the allocation of credit. Yet, these activities are not reflected in any way in the Federal budget. The budget then is deficient as a document which accounts for the effect of congressional action on national objectives.

The subcommittee notes the growing use of private-purpose tax-exempt debt, but defers this type of Federal credit assistance from its recommendations, as the use of the tax code to promote a policy objective is more properly classified as a tax expenditure, as defined by the Budget Act. The subcommittee does, however, favor investigation of the relationship between the congressional budget process and tax expenditures.

Chapter II. HISTORY OF FEDERAL CREDIT ACTIVITIES

The U.S. Government's first major credit program occurred in 1916 with the creation of the Federal Land Bank System. As the first effort to provide a credit system to meet farm needs, the 12 banks in the system were established to make long-term real estate loans to farmers and ranchers. In 1923, Congress also established 12 Federal Intermediate Credit Banks with the authority to purchase short-term notes of farmers and ranchers. Originally wholly owned by the Federal Government, the Land Banks and the Intermediate Credit Banks were later converted to private ownership as part of the Government-sponsored Farm Credit System.

With the entry of the United States into the First World War, Congress established the War Finance Corporation to help finance the war effort. Recipients of credit assistance included the railroads and the merchant marine, as well as foreign governments. The War Finance Corporation was not retired at the end of the war; rather, its functions were extended in 1921 to making agricultural loans.

At that time, procedural control of credit programs by Congress and the executive branch was minimal. The number of Federal credit programs was small, and, with the establishment of a national budget in 1921, concern for financial control was directed at general expenditures.

Expansion of Federal Credit Assistance

In the 1930's, the use of Federal credit assistance grew substantially. In response to the problems facing the banking industry during the Depresssion, the Reconstruction Finance Corporation (RFC) was created in 1932. A wholly Government-owned agency, it was set up to expand the credit available to financial institutions and was also authorized to make direct loans to railroads. In 1934, the RFC's authority was expanded to make industrial loans, and in 1937 a disaster loan corporation was created as an RFC subsidiary. In World War II, the RFC was further expanded and more subsidiaries were created. The agency was terminated in 1953, although several of its subsidiaries still exist; these include the Federal National Mortgage Association (FNMA), the Rural Electrification Administration (REA), the Export-Import Bank (Eximbank), and others.

The RFC was one example of expansion of the use of new Federal techniques to execute policy, including the creation of new agencies that were within the executive branch, but outside the executive departments; the use of Government credit aids as a pro-

gram device; and the chartering of Government corporations as a method of increasing the financial flexibility of Federal loan programs.

In 1933–35, several new credit agencies designed to assist certain sectors of the economy were formed. The Farm Credit Administration was established in 1933 as an independent Federal agency to supervise the Land Bank System and the Intermediate Credit Banks, as well as other Government agricultural credit programs. Shortly thereafter, the 12 Banks for Cooperatives (distributed among the 12 Farm Credit Districts, like the Land Banks and the Intermediate Credit Banks) were chartered to help finance operations of farmers' cooperatives. These too were placed under the supervision of the Farm Credit Administration and were also later converted to private ownership. In 1934, the Commodity Credit Corporation (CCC) was created as a Federal corporation to assist the agricultural sector and to stabilize farm income and prices through the use of price supports.

To encourage the export market, the Export-Import Bank (Eximbank) was also created in 1934. A wholly Government-owned corporation, it was authorized to extend credit to export companies and to foreign countries buying American exports.

Another emergency relief measure was the creation in 1935 of the Rural Electrification Adminstration (REA), which was authorized as an independent agency to make loans to extend electric service into rural areas. REA's authority was expanded in 1949 to make loans to improve rural telephone service.

Housing Credit Assistance

A large segment of the Government's credit activities has been directed at the housing market. In 1934, the Federal Housing Administration (FHA) was created to expand single family homeownership. The basic single family mortgage insurance program of the FHA is now the single largest credit program, in terms of dollar volume, operated by the Federal Government. Mortgage insurance is a guarantee of the repayment of home mortgages provided to lenders. The Veterans' Administration (VA) administers a mortgage assistance program, enacted in 1944, similar to the FHA program but available only to certain veterans.

The Federal National Mortgage Association (FNMA, or "Fannie Mae") was organized to provide a secondary market for home mortgages with Treasury funds. It was created in 1938 as a wholly owned subsidiary of the RFC, but in 1954 became a "mixed ownership" corporation, owned by both the Federal Government and private stockholders. In 1968 FNMA was partitioned into two corporations: the Government National Mortgage Association (GNMA, or "Ginnie Mae") and FNMA.

GNMA is wholly owned by the Federal Government and its activities are included in the Federal budget. Through its mortgage backed security (MBS) program, GNMA effects a secondary mortgage market for FHA and VA loans. Backed by the full faith and credit of the U.S. Government, GNMA-MBS pools include three-fourths of all FHA and VA loans.

FNMA, on the other hand, was rechartered as a privately owned corporation, and its debt securities are not guaranteed by the Federal Government. However, FNMA is exempt from SEC requirements and from all State and local taxes except property taxes. FNMA is now the largest borrower in the country, with the exception of the U.S. Treasury.

Government-Sponsored Enterprises

FNMA is an example of a group of corporations classified in the Federal budget as Government-sponsored enterprises. These enterprises were originally established and chartered by the Federal Government but have since become privately owned while still being sponsored by a Government agency. Seven Government-sponsored enterprises are listed in the Federal budget, including: the Federal National Mortgage Association; the Banks for Cooperatives: the Federal Intermediate Credit Banks; the Federal Land Banks; the Federal Home Loan Banks; the Federal Home Loan Mortgage Corporation; and the Student Loan Marketing Association.

Although Federal outlays in these corporations have grown from $0.4 billion in 1960 to $9.6 billion in 1970 and $33.4 billion in 1981, their operations do not come under the normal Federal budget review process. Created to carry out loan programs, Government-sponsored enterprises are most active in the housing sector, as well as in the areas of agriculture and higher education.

The Farm Credit Administration supervises the Banks for Cooperatives in addition to the Federal Land Banks and the Federal Intermediate Credit Banks as noted earlier. All have been converted to private ownership (the Land Bank System in 1947 and the Intermediate Credit Banks and Banks for Cooperatives in 1968). Their securities are not guaranteed by the U.S. Government.

The Federal Home Loan Bank System was formed in 1932 to provide a secondary source of housing credit for the savings and loan industry, and the Federal Home Loan Bank Board was established to supervise them. Although the Government's investment in the corporation was retired by 1951, the Federal Home Loan Bank System is still defined as a mixed-ownership corporation and the Banks are still under the supervision of the Board, an on-budget agency whose members are appointed by the President. Federal Home Loan Bank securities are not guaranteed by the Federal Government.

The Federal Home Loan Mortgage Corporation (FHLMC, or "Freddie Mac") was chartered in 1970 to expand the secondary mortgage market. Created without Government funds, it has always been privately owned, but is also supervised by the Federal Home Loan Bank Board. FHLMC is also exempt from all State or local taxes other than property taxes.

The Student Loan Marketing Association (SLMA, or "Sallie Mae") was created in 1972 in response to the increasing costs of higher education, as a Government-sponsored, private corporation to provide a secondary market for student loans.

12-819 O - 83 - 3

Establishment of the Federal Financing Bank

By the early 1970's, the number of Federal agencies authorized to borrow from the public or to sell some type of security in the private credit markets had proliferated to the point that small agency-backed security offerings were occurring frequently although the securities had essentially the same risk and purpose—Federal borrowing to finance Government programs. Lack of standardization in the securities resulted in unfamiliar terms and provisions. In addition, the number of private borrowers with Federal guarantees in the private credit markets was increasing significantly.

In 1974, the Federal Financing Bank (FFB) was created as a unit of the Treasury Department to serve as a clearinghouse for all agency debt. The FFB was given the authority to purchase any fully guaranteed security or loan issued by a Federal agency. In turn, the FFB was authorized to issue its own securities with a limit on the amount outstanding of $15 billion and was given unlimited authority to borrow from the U.S. Treasury.

This funnel concept allowed one Federal security to substitute for a multitude of agency securities and eliminated the need for duplicative financing staffs among several agencies. The name of the FFB was self-descriptive. As a financing mechanism for a large number of Federal agencies, the FFB was to operate as a bank—borrowing money through the issuance of securities and lending money to Federal agencies in need of financing to operate their programs.

With the creation of the FFB, the number of borrowers backed by the full faith and credit of the U.S. Government was to be reduced to two: the Treasury and the FFB. In 1974, the FFB issued $1.5 billion of its own securities. After this single issuance the FFB has borrowed exclusively from the Federal Treasury. Therefore, the activities of the FFB were never limited by the $15 billion cap placed on its authority to borrow from the public. At the end of fiscal year 1981, its outstanding debt to the Treasury exceeded $82 billion.

The receipts and disbursements of the FFB were placed off-budget to prevent duplication of the transactions of the borrowing agency. As a central financing mechanism, a duplication of transactions would occur if the original loan was included in the budget of the initiating agency and if the funding transaction of the FFB was included in the Federal budget. Because of the interrelationship of the budgetary treatment of the FFB and certain agency transactions, however, the FFB has allowed agencies to place outlays permanently off-budget. This is discussed in greater detail in chapter III.

Activity of the FFB has increased rapidly since its creation. In fiscal year 1975, its first full year of operation, the FFB conducted net lending of $12.7 billion. By fiscal year 1981, net lending totaled $24.8 billion, and $107.3 billion in loans were outstanding after 7 full years of operation.

Chapter III. FINDINGS OF THE SUBCOMMITTEE

Budgetary Treatment of Federal Credit

As a document of Federal activity, the Federal budget should fully capture the current effect of current and prior congressional action and policy. A budget has value only as a tool for the Congress to make informed decisions, as a reference for others to evaluate national policies, and as a benchmark of performance. An incomplete budget has substantially diminished value and may not fulfill the needs for which it is used.

A budget is simply an aggregation of individual accounts and funds. These smaller components are used for convenience and efficiency, and represent the budgets of smaller units of government. Transactions of the Federal Government are as diverse in nature as the objectives of government itself. They include transfer payments to individuals, construction of highways, acquisition of land, grants to other governmental units, and the purchase of military hardware. Sources of financing are again as diverse. Money flows to the treasury from taxes on income, excise taxes on specific activities, the sale of Federal assets, and the imposition of fines.

Different activities of Government are accounted for under different techniques and in separate types of funds. An activity which is financed by a tax or other revenue source earmarked specifically for that activity is generally accounted for as a trust fund. Examples are the social security trust funds financed by payroll taxes and unemployment compensation trust funds financed by assessments on employers. Activities which generate some form of revenues are generally accounted for in revolving funds, discussed in greater detail below.

In 1967, the President's Commission on Budget Concepts recommended that the Federal Government adopt a unified budget; this recommendation was followed beginning with the fiscal year 1969 budget. The unified budget concept requires all Federal activity to be captured in one document regardless of the type of activity, the means of financing, the type of expenditure involved, or the type of fund used to account for the activity.

One budget capturing all activities was deemed superior to several budgets separated by type of activity or source of financing. This is the way the congressional budget is intended to be constructed and the way in which it is perceived.

Accordingly, the unified budget was developed, based on three measurements: budget authority, outlays, and revenues.

Budget authority represents authority provided by law to enter into obligations in the budget year which will result in immediate or future disbursements. The timing of the disbursements depends

on the nature of the obligation. Budget authority used to acquire the services of a Federal employee will result in an equivalent disbursement within a pay period. Budget authority used to contract for the construction of a satellite may result in disbursements over a period of years. This authority to obligate funds is granted by Congress through statute, most frequently through appropriations acts.

Cash disbursements from the treasury resulting from such obligations are termed *outlays* in the budget. Outlays are not explicitly appropriated, but simply flow from the authority to enter into obligations that has been granted by Congress. The total amount of outlays that will occur in a budget year is an estimate based on budget authority granted by the Congress in the current and previous years.

The third component of the congressional budget, *revenues*, is an estimate of the amount of tax collections and other cash inflow that will occur in a budget year as a result of the sovereign authority of the Government to collect taxes and exercise other powers involving collections.

In summary, three measurements of Federal activity are currently available to represent all financial transactions of the Federal Government and serve as the basis of the Federal budget. All evaluation of Federal financial activity—size of government, growth of government, allocation of resources among different priorities—is necessarily done through the use of these bases of measurement. The difference between the two measures of cash flow—revenues and outlays—is the deficit or surplus of any given budget.

The subcommittee concludes that the budgetary treatment of Federal direct loans and loan guarantees is incomplete in the context of a unified budget. It finds that the methods used to account for direct loans and loan guarantees understate the true level of activity. As a result, the true size and scope of Federal spending and Federal borrowing requirements are not adequately reflected in the budget totals.

Specific budgetary problems that need to be addressed are:

—*Off-budget spending.* Certain agency spending is excluded from budget outlay totals even though it consumes cash resources and requires additional Federal borrowing.

—*Revolving funds.* An accounting technique known as revolving funds offsets certain revenues against outlays and, therefore, displays an outlay level much lower than actual cash outflow.

—*Loan asset sales.* Agencies which finance their loan activity through a transaction with the Federal Financing Bank are able to remove the impact of their activity from their budget and transfer it to the off-budget Federal Financing Bank.

—*Federal Financing Bank conversion of loan guarantees to direct loans.* Another agency use of the Federal Financing Bank results in an off-budget Federal direct loan being provided to a client of the agency who has received a loan guarantee from that agency.

—*Federal loan guarantees.* The contingent liability resulting from a loan guarantee is entirely excluded from current budget measurements.

Off-Budget Spending

The budgets of certain agencies are excluded by statute from the official Federal budget. Further distinctions from other on-budget activities are, in most cases, difficult to detect.

Off-budget activity has existed since before enactment of the Congressional Budget Act (Public Law 93–344) in 1974. Although the disbursements of off-budget agencies are not included in the outlays of the budget, they contribute to the need for Federal borrowing and have made a significant contribution to the growth in the national debt. Table 1 shows the history of on- and off-budget deficits since 1973. As shown in the table, off-budget outlays contributed to an increase in the national debt of $85.5 billion as of the end of fiscal year 1981.

Table 1

BUDGET DEFICITS, FISCAL YEARS 1973–81

[In billions of dollars]

Fiscal year	Unified budget deficit	Off-budget defict	Total budget deficit	Off-budget deficit as a percentage of the total budget deficit
1973	14.8	0.1	14.9	0.7
1974	4.7	1.4	6.1	23.0
1975	45.2	8.1	53.2	15.2
1976	66.4	7.3	73.7	9.9
TQ [1]	13.0	1.8	14.7	12.2
1977	44.9	8.7	53.6	16.2
1978	48.8	10.4	59.2	17.6
1979	27.7	12.5	40.2	31.1
1980	59.6	14.2	73.8	19.2
1981	57.9	21.0	78.9	26.6
Total	383.0	85.5	468.5	18.2

[1] Transition quarter.

Source: Congressional Budget Office.

The largest off-budget agency is the Federal Financing Bank, which has accounted for 96 percent of off-budget outlays through September 30, 1981, as shown in table 2. The off-budget outlays of the FFB are due exclusively to Federal credit activities.

Table 2

FEDERAL FINANCING BANK OUTLAYS AS A PERCENTAGE OF THE OFF-BUDGET DEFICIT, FISCAL YEARS 1973–81

[In billions of dollars]

Fiscal year	FFB outlays	Off-budget deficit	FFB outlays as a percentage of the off-budget deficit
1973		0.1	
1974	0.1	1.4	7.1
1975	6.1	8.1	75.3
1976	6.0	7.3	82.2
TQ [1]	2.6	1.8	144.4
1977	8.1	8.7	93.1
1978	10.7	10.4	102.9
1979	13.3	12.5	106.4
1980	14.4	14.2	101.4
1981	21.0	21.0	100.0
Total	82.3	85.5	96.3

[1] Transition quarter.

Source: Congressional Budget Office.

Revolving Funds

The second factor contributing to an incomplete budget is the method by which direct loan programs are generally accounted for. Most direct loan programs operate in essentially the same manner although terms vary among programs. A borrower applies for a loan, program administrators review the application to determine eligibility, and upon satisfaction of program criteria, an agreement is reached which obligates the Federal Government to make a loan. If the borrower continues to meet the conditions of the agreement, funds are disbursed and the loan occurs. The final stage of the transaction occurs when the borrower performs his or her duty to repay, and principal and interest payments are made to the lending agency. In theory, the obligation to make a loan constitutes the use of budget authority, and the disbursement of funds constitutes outlays. Thus, if a particular program had authority to enter into direct loan agreements totaling $700 million and disbursed $525 million during a year, the budget should reflect this activity by including $700 million in budget authority and $525 million in outlays. These amounts would be fully reflected in the budget.

Because of the accounting technique known as "revolving funds," however, the amount of budget authority and outlays included in the budget is substantially less than the true amount of activity that occurs.

Revolving funds involve offsetting loan principal and interest payments against total new lending activity. Only the net amount of activity is included in the Federal budget. Cash outflows (loan disbursements in the case of a direct loan program) are offset by

cash inflows (loan principal and interest payments in the same case). Obligations of a program are also offset by cash inflows. Thus, the total or gross amount of direct loan activity is not represented by the budget authority and outlays of a loan program accounted for in a revolving fund.

Using a hypothetical loan program that had authority to enter into $700 million in obligations to make new loans, disbursed $525 million in actual new loans, and received $100 million in principal and interest payments, the example below illustrates that the activity levels of the program as a component of the budget would be $600 million in budget authority and $425 million in outlays.

EXAMPLE

[In millions of dollars]

	Budget authority	Outlays	Revenues
New direct loan obligations:			
$700 million	700		
New direct loan disbursements:			
$525 million		525	
Principal and interest repayments:			
$100 million	(100)	(100)	
Budget display	600	425	

The effect of this accounting practice is to understate direct loan activity within the Federal budget. For a given program, the budget figures will change from year to year not only by the change in program levels but also by the pattern of repayments resulting from prior program levels. Put another way, two programs with identical obligation levels and cash outflows will have different budget figures and will therefore appear to be operating at different program levels if one is accounted for as a revolving fund and the other is not.

Most direct loan programs are accounted for through the use of revolving funds. As a result, in fiscal year 1981 $55.9 billion in loan disbursements were made throughout the Government but only $5.2 billion, or 9 percent were shown as outlays in the Federal budget. This not only understates the amount of direct lending reflected in the budget but also erodes the integrity of the budget totals as a measure of annual fiscal activity.

Thus, Congress and other users of the Federal budget are unable to make important distinctions among various credit programs or to evaluate the activity of specific credit programs across time.

Loan Asset Sales

Frequently, Federal assets are sold to nongovernmental purchasers and cash is generated. Examples of asset sales are the sale of Federal land or the sale of federally owned natural resources such

as timber or minerals. The cash generated by these sales are netted against the budget of the selling agency. If a program accounted for as a revolving fund sells an asset for cash, however, the receipts from the sale are counted as an offset in the fund. Such offsets decrease the amount of budget authority and outlays of the program.

The assets of a loan program are the loans themselves. Any sale of those loans to a financial institution for cash would constitute a sale of Federal assets or, specifically, loan asset sales. Some of the largest direct loan programs engage in transactions with the FFB to replenish their cash balances using "certificates of beneficial ownership" (CBO's) that are, by statute, allowed to be treated as a loan asset sale.

An agency, which has made large numbers of direct loans, will issue a certificate (CBO) to the FFB backed by "beneficial ownership" in a pool of those loans. In return for the CBO, the FFB will advance funds to the agency in the amount of the principal of the loans in the pool. Simultaneously, the issuing agency contracts to repurchase the CBO at a specified time along with interest at a rate set by the FFB. The date of repurchase is set by the issuing agency and rarely coincides with the maturity of the underlying loan pool.

Loan servicing of the loan pool—collection of principal and interest payments—is continued by the issuing agency. Regardless of performance by the non-Federal borrower, repayment of the CBO is guaranteed to the FFB by virtue of the repurchase agreement.

This transaction is, in substance, the same as the sale of a bond—a financing transaction. For purposes of budget accounting, however, the transaction is treated as the sale of a loan although neither the loan nor the risk is transferred to the FFB. The budget authority and outlay figures of the issuing agency are reduced since the funds advanced by the FFB are counted as offsets in the revolving fund. The budget authority and outlay figures of the off-budget FFB are increased because FFB funds have been obligated and disbursed. The effect of CBO sales is to transfer the activity of the on-budget lending agency to the off-budget category even though the transaction has not changed the fiscal status of the Federal Government.

The example below shows the effect of the earlier example if $400 million in CBO's were sold to the FFB. Table 3 depicts the history of loan assets purchased by the FFB since 1976.

EXAMPLE

[In millions of dollars]

	On-budget			Off-budget (FFB)		
	Budget authority	Outlays	Revenues	Budget authority	Outlays	Revenues
New direct loan obligations:						
$700 million	700					
New direct loan disbursements:						
$525 million		525				

EXAMPLE—Continued

[In millions of dollars]

	On-budget			Off-budget (FFB)		
	Budget authority	Outlays	Revenues	Budget authority	Outlays	Revenues
Principal and interest repayments:						
$100 million	(100)	(100)				
CBO sales:						
$400 million	(400)	(400)		400	400	
Budget display	200	25		400	400	

FFB Conversion of Loan Guarantees to Direct Loans

In addition to CBO sales, the FFB facilitates another type of transaction which is accounted for in a way which understates direct loan activity. These transactions are termed FFB direct loans.

Many programs provide authority to guarantee loans but not to provide direct loans. However, it is possible to provide a program applicant with a Federal direct loan simply by giving the borrower a 100-percent Federal guarantee and sending him or her to the FFB. The FFB is empowered to provide a direct loan to any borrower with a Federal guarantee and does so by arrangement with the guaranteeing agency. Thus, any agency with the power to guarantee loans has the power to provide direct loans through the FFB.

Since the on-budget agency never advances funds, no budget authority or outlays show up in their records. The budget authority and outlays of the off-budget FFB, however, are increased by the amount of the loan. Although the Federal Government has provided a direct loan to a non-Federal borrower, no trace of this transaction can be found in the Federal budget. Furthermore, an agency not empowered to provide a direct loan has effected a direct loan by using another agency of the Government.

Table 3 also displays the history of FFB conversions of loan guarantees to direct loans since 1976.

Table 3

TRANSACTIONS OF THE FEDERAL FINANCING BANK, FISCAL YEARS 1976–81

[In millions of dollars]

Fiscal year	FFB purchases of loan assets	FFB conversion of loan guarantees to direct loans
1976	4,140	6,131
TQ [1]	2,115	2,623

Table 3—Continued

[In millions of dollars]

Fiscal year	FFB purchases of loan assets	FFB conversion of loan guarantees to direct loans
1977	7,116	12,379
1978	8,716	15,309
1979	10,912	16,045
1980	12,110	22,189
1981	15,208	30,268

[1] Transition quarters.

Source: Congressional Budget Office.

Loan Guarantees

Loan guarantees provide the full faith and credit of the Federal Government to a selected class of borrowers to achieve policy objectives. Although Federal funds are not involved at the point the guarantee is issued, the guarantee does create a contingent liability for the U.S. Government that could result in the expenditure of Federal moneys at some future time. In the case of default by the borrower, the expenditure of Federal dollars is mandatory. Yet Federal guarantees are not included in the Federal budget in any manner. Guarantees are generally not counted as budget authority due to Section 3(a)(2) of the Budget Act which specifically excludes loan guarantees from the definition of budget authority. Budget authority and outlays are counted, however, if the Government must perform under its guarantee obligation and make payment for a defaulted borrower.

The example below illustrates the effect if the program assumed earlier were to enter into $900 million in new loan guarantee commitments and directed the FFB to fund $600 million of those. Note that under the assumptions used, the program has caused $1.125 billion in new direct loans to be made—and, therefore, $1.125 billion in new Federal borrowing to occur—yet the Federal budget displays only $25 million in outlays. Program activities have caused obligations resulting in immediate or future outlays of $1.3 billion and the guarantees not funded by the FFB represent $300 million in contingent liability. However, the Federal budget will show the consumption of only $200 million in budget authority for all this activity. A Federal program has caused a cash inflow of $100 million, yet no trace of that inflow is apparent in the Federal budget which is essentially based on a cash flow basis. The example illustrates the results that can occur from the current methods used to account for Federal credit activities.

EXAMPLE

[In millions of dollars]

	On-budget			Off-budget (FFB)		
	Budget authority	Outlays	Revenues	Budget authority	Outlays	Revenues
New direct loan obligations: $700 million	700					
New direct loan disbursements: $525 million		525				
Principal and interest repayments: $100 million	(100)	(100)				
CBO sales: $400 million	(400)	(400)		400	400	
New loan guarantee commitments: $900 million						
FFB conversion of loan guarantees to direct loans: $600 million				600	600	
Budget display	200	25		1,000	1,000	

The subcommittee concludes that the omission of significant amounts of Federal assistance from the Federal budget is inconsistent with the purpose of a budget as a document of Federal activity.

Budgetary Control of Federal Credit

A budget process should provide an institutional mechanism for Congress to assess the financial activity of Government, determine an appropriate level of activity in light of economic conditions and policy objectives, and exercise the degree of control over that activity that it feels is necessary to meet its obligations as a legislative body. Adequate control, under most circumstances, should consist of more than the ability to determine a level of activity. The nature of the legislative process and the size and complexity of the Federal Government require that the financial activity of the Government be subject to an organized and systematic process of evaluation, determination, and enforcement.

The congressional budget process is designed to provide a framework within which aggregate Federal revenues and Federal spending can be evaluated. A determination of aggregate activity can be made through the adoption of a budget resolution; the activity of a particular program is designed to be controlled through the enactment of budget authority. The degree and effectiveness of control depends upon the frequency of review available to Congress and the manner in which the statutory source of authority to conduct financial activity is granted by Congress. These are factors that

result from program design and the amount of discipline Congress wishes to impose upon itself.

Programs which are entitlements in nature (such as railroad retirement, aid to families with dependent children (AFDC), and Federal pensions) can be controlled only to the extent that Congress chooses to alter the underlying legislation which created the program. No institutional process exists which imposes an annual review—or any periodic review—of such legislation.

Other programs which are discretionary in nature (such as national defense, block grants to States, and foreign aid) are generally subject to the appropriations process, which not only requires an annual determination of activity through the enactment of budget authority but allows this determination to be made in the context of a bill which can be compared to overall decisions made in a budget resolution.

The existing budget process is designed to address spending activity of the Federal Government. Because Federal credit activity does not possess the characteristics of spending, neither direct loans nor loan guarantees are adequately controlled through the current statutory budget process.

Loan Guarantees

The Budget Act requires annual determinations of budget authority and outlays only. Barring default, loan guarantees do not require the Government to enter into obligations which will result in immediate or future outlays. Because loan guarantees do not generally come within the definition of budget authority (they are specifically excluded from the definition of budget authority found in Section 3(a)(2) of the Budget Act), they are generally excluded from the formulation of the congressional budget.

Loan guarantees do appear as budget authority and outlays in the Federal budget if the borrower defaults on his obligation to repay his creditor. Since the Government is obliged to fulfill its full faith and credit guarantee, the outlay is uncontrollable as Congress has little discretion in the required appropriation. Thus, the annual level of any guarantee program is beyond the traditional appropriations and budget process. Once created, guarantee programs can operate without any effective form of congressional constraint.

Although a few guarantee programs are limited by authorizing statute to a maximum amount that can be outstanding at any point in time, most do not place a limitation on annual activity. The Congress has no mandatory institutional mechanism available to determine the annual activity of guarantee programs short of placing such limitations in each underlying authorization.

Direct Loans

The obligation to make a direct loan requires the use of budget authority, and disbursement for the loan is counted as an outlay. As the overwhelming number of direct loan programs are established as revolving funds, however, the amount of budget authority appropriated for a program may have little bearing on the amount of actual obligations for direct loans which can occur. Moneys which are paid back to the Government under the loan program

are usually available for further obligation. Both new budget authority and outlays are reduced by the amount of the repayment. Thus, a direct loan fund might well have a substantially larger amount of money available for obligation than the annual appropriations for that loan program would suggest.

The offsets to budget authority and outlays result not only from repayments but, under current budget treatment, also from the amount of CBO sales to the FFB. While neither of these are controllable by Congress, the amount of CBO sales—and the amount of authority available for new obligations—can be controlled by program administrators.

The revolving fund concept and the ability to place direct loans outside the budget through loan asset sales have obscured the activity levels of most direct loan programs in relation to the budget authority and outlay amounts included in the budget. Of the $60 billion in loan disbursements in fiscal year 1981, only $8.8 billion or 15 percent was reflected as net outlays in the budget.

The use of direct loans and loan guarantees as a technique to implement policy has exploded since passage of the Congressional Budget Act in 1974. In 1974, $61.5 billion in direct loans and $180.4 billion in loan guarantees were outstanding. After 8 years, the growth in outstanding direct loans had grown over 200 percent and outstanding loan guarantees had grown over 71 percent.

Table 4 lists the amount of new direct loans and new loan guarantees that have occurred each year since 1970 and the amount outstanding at the end of each year.

Table 4

SUMMARY OF ANNUAL AND OUTSTANDING DIRECT LOAN OBLIGATIONS AND LOAN GUARANTEE COMMITMENTS, FISCAL YEARS 1970–81

[In millions of dollars]

Fiscal year	Direct loans obligations	Primary loan guarantee commitments	Secondary loan guarantees	Total outstanding direct loans	Total outstanding loan guarantees
1970	10,444	27,482	438	51,078	125,076
1971	10,451	35,547	3,000	53,156	140,118
1972	8,498	44,808	3,518	50,149	158,913
1973	18,073	36,411	3,607	57,090	174,073
1974	19,205	29,267	4,375	61,485	180,446
1975	34,909	30,467	5,905	74,142	188.966
1976	35,339	26,147	9,188	85,879	200,727
TQ [1]	8,335	8,882	2,609	89,572	200,468
1977	45,821	58,784	17,255	100,893	214,061
1978	58,331	54,987	17,636	120,454	226,111
1979	51,402	86,878	42,360	140,516	264,596
1980	51,081	82,217	64,393	163,928	298,546
1981	57,194	76,515	44,113	184,962	309,056

[1] Transition quarters.

Source: Congressional Budget Office.

Credit Control System

In response to the rapid growth of Federal credit activities, the Carter administration announced a credit control system in its fiscal year 1980 budget. This system has been retained by the Reagan administration.

The control system included annual aggregate and functional credit targets for direct loans and loan guarantees. Prior to this time, data on Federal credit activity had been accumulated and presented only once a year in a Special Analysis accompanying the President's January budget submission.

The new credit budget established as the point of control for direct loans the time of obligation rather than disbursement; the control point for loan guarantees was set at the time of commitment rather than the time of issuance. The credit budget was also based on *gross* or total amounts of new credit activity to overcome the understatement that resulted from the netting process of revolving funds and the exclusion of certain types of credit activity from the traditional components of the budget.

To enhance enforcement of the targets, the appropriations requests sent to Congress by the administration included legislative language placing annual limitations for selected programs on the maximum amount of gross new direct loan obligations and gross new loan guarantee commitments into which an agency could enter. Many programs, however, were exempted from this portion of the control system by the administration.

The Appropriations Committees have included in appropriations bills many, but not all, of the limitations on direct loan obligations and loan guarantee commitments requested by the administration. Any request for limitation not acted on by the Appropriations Committee causes further exemption of programs from the enforcement portion of the credit control system.

As an example of the coverage of appropriations limitations, table 5 below shows the portion of Federal credit activity subjected to limitations during fiscal years 1979–81.

Table 5

FEDERAL DIRECT LOANS AND LOAN GUARANTEES SUBJECT TO APPROPRIATIONS LIMITATIONS AND EXEMPT FROM ANNUAL LIMITATION

[By fiscal year, in billions of dollars]

	Actuals		
	1979	1980	1981
Direct loans:			
Exempt from limit	31.6	48.8	48.8
Subject to limit	12.2	12.6	24.4
Gross direct loans	43.8	61.4	72.4

Table 5—Continued

[By fiscal year, in billions of dollars]

	Actuals		
	1979	1980	1981
Percent subject to limit	27.8	20.5	33.7
Loan guarantees:			
Exempt from limit	133.1	156.5	41.2
Subject to limit	2.0	2.4	111.4
Gross guarantees	135.1	158.9	152.7
Percent subject to limit	1.5	1.5	73.0
Number of programs subject to limit:			
Direct loans	7	7	24
Loan guarantees	3	4	15

Source: Congressional Budget Office.

Congressional Action on Control of Credit

In response to the administration's initiative, aggregate targets for Federal credit activity were included in the conference report on the First Budget Resolution for FY 1981.

The First Budget Resolution for FY 1982 added targets by function to the aggregate levels and included "sense of the Congress" language calling upon Congress and the President to restrict FFB activity to specified levels.

The First Budget Resolution for FY 1983 included significant advances in enforcement of the credit budget. The resolution required that the joint explanatory statement of the conferees on the budget resolution include an allocation or "crosswalk" of the credit targets among appropriate congressional committees.

The resolution further created two points of order. First, a point of order was provided against legislation considered after adoption of the Second Budget Resolution for FY 1983 which would cause the aggregate levels of new direct loan obligations or new primary or secondary loan guarantee commitments for fiscal year 1983 to be exceeded.

The second point of order would lie against consideration in fiscal years 1982 and 1983 of legislation that authorizes new direct loan obligations, or new loan guarantee commitments, unless such authority is effective only to the extent provided in appropriation acts. Exempted from the provision were agricultural price support and related programs funded through the Commodity Credit Corporation, loan and loan guarantee programs administered by the Veterans Administration, and bills and resolutions reported prior to adoption of the resolution.

Executive Reporting of Actual Credit Activity

Congress and the administration have significantly advanced the development of a process of formulating a credit budget prior to the beginning of a fiscal year and during the annual appropriations process. This formulation is but one stage of an adequate process of establishment and implementation of policy. Financial activity does not stop at the end of the planning process; data on the actual levels of activity—both direct loan obligations and disbursements and loan guarantee commitments—should be available to allow for adequate monitoring.

At present, the executive branch does not collect data on actual credit activity beyond the agency level until the end of the fiscal year, nor does summary reporting of total Federal credit activity occur on a periodic basis throughout the fiscal year. As a result, information on the actual level of total Federal credit activity is not available to Congress until 4 months after the end of the fiscal year when the information is included in the next January budget submission.

The subcommittee concludes that the present system of reporting actual Federal credit activity should be expanded to enable Congress to better determine appropriate Federal policy.

Revisions of Annual Activity Levels

For much of Federal credit assistance, determination of annual levels of activity has been effectively delegated to the executive branch. Reasons for this include the lack of systematic congressional treatment of Federal credit activity, the budgetary distortion of direct loan activity resulting from the revolving fund concept, the exclusion of loan guarantees from the budget process, and inadequate reporting of actual credit activity.

Direct loan programs that employ the technique of CBO sales can alter those sales to arrive at a congressionally enacted level of budget authority that may not result in the amount of new direct loan obligations that underlie the amount of budget authority appropriated. Loan guarantee programs that have no annual level set through appropriations or other legislation must operate at levels determined by the executive branch.

For those guarantee programs that are included in appropriations acts, the language generally places only limitations on annual activity: on the face of the language, no required level of activity can be found. This is not true for all programs. Recent appropriations bills have included minimum levels of activity for a small number of selected credit programs.

The lack of congressional direction for annual levels of activity can result in programs which operate simply at the level of demand and become, in effect, entitlement programs. In some cases, activity levels are implied in statute, but no institutional process exists to allow the executive to alter those levels if conditions warrant.

The Impoundment Control Act of 1974 was enacted to provide the executive branch with a mechanism to revise legislative priorities, through the process of rescission and deferral, while recognizing Congress role in the establishment of fiscal policy. However,

the act addresses only the revision of budget authority which does not adequately reflect an intended level of new direct loan obligations and which omits commitments for new guarantees.

The subcommittee concludes that Congress should establish procedures for initiating changes in congressionally set levels of annual credit activity. These procedures should assure that both the executive and the Congress are able to exercise appropriate control, as provided for other spending programs by existing rescission and deferral procedures.

Subsidies

Federal credit assistance can result in a reallocation of available credit which allows a borrower to obtain funds that would not be available without Federal assistance. Generally, another benefit is afforded the borrower in the form of a lower rate of interest than would otherwise be available. This lower interest rate is, in effect, a subsidy provided by the Federal Government to the borrower.

In basic terms, the market rate of interest that any borrower must pay is the result of two components. The first is the rate of interest that will cover the cost of funds and other expenses incurred by the lender and allows for an adequate rate of return for the shareholders of the lending institution. The second component is a risk premium that compensates lenders for the expected probability of loss that will occur if the borrower is unable to repay.

The Federal Government is regarded as the most credit-worthy borrower in the market and, therefore, is able to borrow at a lower rate of interest than any other competing borrower. A private lender is able to view Federal guarantee recipients as risk-free since repayment is assured by the Federal Government. As a result, federally guaranteed borrowers are able to borrow at a lower rate of interest than they would otherwise face. The difference between these two rates is a subsidy afforded by the Federal guarantee.

Thus, in any situation in which a borrower receives a rate of interest on a loan lower than he would have received as an unassisted borrower, the difference in the two rates represents a real subsidy to that borrower. The total subsidy accrues because of the assistance provided by the Federal Government. However, from the Government's perspective, the subsidy may be direct or indirect. For loan guarantees, the total subsidy is indirect—no money flows from the Treasury—but real nonetheless.

New direct loans also provide subsidies if the loan received by the borrower carries a rate of interest lower than that which a private lender would charge. The subsidy of a direct loan can be both direct and indirect. If a direct loan carries an interest rate equal to the cost of funds to the Treasury (i.e. the Government's borrowing rate) no direct cost occurs to the Government, but the borrower receives an indirect subsidy equal to the difference in the Treasury rate and the rate charged the direct loan recipient.

Although the interest rate charged to a direct borrower can be structured in a manner that will cover the interest cost incurred by the Treasury, many direct loan programs charge a rate of interest that is substantially below the cost of funds to the Government.

The spread between these two rates is a direct cost to the Government and a direct subsidy to the borrower.

As an example, if a participant in a direct loan program is able to borrow from the Government at 5 percent, but would otherwise pay 15 percent as an unassisted borrower, the participant enjoys a subsidy equal to the 10 percentage point reduction in interest.

Assuming that the Treasury borrowing rate is 11 percent, a direct subsidy of 6 percentage points (11 percent minus 5 percent) is borne by the Federal Government in making this loan, using real budget resources. The remainder of the total subsidy accrued by the borrower, 4 percentage points, is indirect.

FFB Loans

Private borrowers who receive direct loans from the FFB pay one-eighth of 1 percent above the cost of Government funds as calculated by the Treasury. These loans are not market rate loans and carry a rate of interest lower than the borrower would pay on an unassisted loan. Thus, they also provide an indirect subsidy to the borrower.

Total Subsidies Provided

Precise measurements of both the direct and indirect subsidies resulting from Federal credit programs are difficult to produce. Such measurements require an estimate of the market rate a borrower would face if no Federal assistance were provided. If private loans are not made to comparable borrowers, no market rate can be established and any estimate would be tenuous at best. Thus, no satisfactory estimate of the total subsidies resulting from Federal credit assistance exists. However, Special Analysis F of the Federal Budget estimates the value of subsidies provided to direct loan recipients and finds that this one type of subsidy involved in Federal credit assistance exceeded $14 billion in fiscal year 1981.

The lack of data on credit subsidies and their effect on the economy indicates the need for further understanding of the impact of Federal credit activity now exceeding a volume of $130 billion a year. This situation underscores the need for greater Government-wide review of Federal credit activities that must begin with incorporation of these activities in the budget process.

Defaults

For Congress effectively to meet its oversight responsibilities as a legislative body, it is critical that adequate information be provided that allows a responsible evaluation of the efficacy and cost of each program. Knowledge of the default rate of a credit program is fundamental to such an evaluation. The rate of default can indicate that credit assistance may not be effectively promoting the goals of the program or that management of the program is inadequate. Further, a default changes a loan to a grant.

Budgeting involves tradeoffs of competing needs in the context of limited resources. If Congress cannot compare the impact of different allocation of budget resources, its decisionmaking process can be impaired.

Determination of the point at which a loan is in default is a difficult process. Some programs define various stages of delinquency and default under guidelines provided by statute, but most operate under criteria determined by program administrators. No standard definition of default exists throughout the Federal Government. As a consequence, a comparison of the default rate among programs cannot be made. Accordingly, a comparison of costs among programs cannot be made.

The lack of a standard definition of default does not preclude an institutionalized budget process for credit but it does impede an efficient use of Government resources and hampers the ability of Congress to provide adequate oversight.

One particular aspect of current techniques used to account for defaults is inappropriate. At present, a Government outlay resulting from a defaulted Federal guarantee is counted as a new direct loan by the Federal Government to the defaulted guarantee recipient. Although the Federal Government is entitled to repayment for this outlay and collection frequently does occur, it is inaccurate to treat this outlay as a new loan in the Federal budget. No new extension of credit in the economy has occurred. If aggregate new direct loans, as displayed in the budget, include a mixture of payments to satisfy previous guarantee commitments, the informational integrity of the aggregate is diminished and the information provided by credit aggregates is misleading as to their effect on the economy and as a statistic of Government activity.

Role of the Federal Financing Bank

The operations of the Federal Financing Bank (FFB) are intertwined with a vast portion of Federal loan and loan guarantee programs. A distinction must be made, however, between the operations of the FFB and the effect of the FFB on the Federal budget and budget process. The purpose of the FFB to eliminate uncoordinated issuance of agency debt and duplicative staffing among agencies constitutes sound management practice.

The subcommittee concludes, however, that the budgetary treatment of the budget authority and outlays resulting from the operations of the FFB requires modification. In particular, attribution of budget authority and outlays should be to the agency exercising its authority to effect direct loans, not to the FFB.

Issuance of certificates of beneficial ownership (CBO) by an agency to the FFB should not be treated as a sale of assets. The title and risk associated with the underlying loan does not transfer from the agency and the FFB has full recourse to the issuing agency for proceeds issued in connection with the CBO transaction. The FFB has simply provided financing for the program and no sale of assets has occurred. This relationship should be properly reflected in the Federal budget and the true source of Federal outlays should be appropriately displayed.

Chapter IV. RECOMMENDATIONS OF THE SUBCOMMITTEE

The subcommittee recommends that Federal credit activities be permanently integrated into the congressional budget process. The full committee is urged to report legislation that would incorporate Federal direct loans and Federal loan guarantees into all phases of the budget process, consistent with the manner in which direct spending is now.

To assure that the Federal budget accurately represents Federal activity and overcomes the inability of existing budget concepts to encompass credit activities, direct loan authority and loan guarantee authority should be established as budget concepts to serve as credit analogs of budget authority. These concepts should then be incorporated in the provisions of the Congressional Budget Act, including the following:

—Reports of congressional authorizing and appropriations committees to the Budget Committees should include views and estimates on new direct loan obligations and new loan guarantee commitments within their respective jurisdictions.

—The Congressional Budget Office should continue to provide information to Congress on Federal credit activities.

—Concurrent budget resolutions should continue to include aggregate and functional totals for new direct loan obligations and new loan guarantee commitments.

—Direct loan obligation and loan guarantee commitment totals contained in budget resolutions should be allocated to authorizing and appropriations committees under the "crosswalk" procedures included in Section 302 of the Congressional Budget Act.

—Direct loan obligations and loan guarantee commitments should be subject to the reconciliation process.

—All points of order provided by the Congressional Budget Act against bills or resolutions that conflict with the provisions of the Budget Act or provisions of budget resolutions should be expanded to incorporate direct loan obligations and loan guarantee commitments.

Congressional Consideration of Credit

Fundamental to adequate control of Federal credit is the existence of a point in the legislative process that will allow Congress to view the aggregate effect of actions on individual programs in the

context of an existing credit budget. Clearly, the only existing process that is sufficiently encompassing to effectively result in the creation of such a focal point is the appropriations process. Therefore, the authorization or reauthorization of new direct loan authority or loan guarantee authority should be effective only to the extent that annual levels of activity are provided for in appropriations acts.

Treatment of Defaults

New direct loans should not include disbursements made pursuant to satisfaction of a Federal guarantee of a defaulting borrower. Although the debtor is technically obligated to repay the Government for the expenditure, the outlay does not result in a net extension of credit in the economy. Thus, direct loan totals are overstated in terms of their economic impact and default rates are disguised if these actions are counted as new direct loans. Disbursements resulting from defaulted guarantees should simply be counted as budget authority and outlays.

Impoundment Control

Any revision of annual levels of new direct loan obligations and new loan guarantee commitments by the executive branch as determined by Congress should be accomplished through the procedures established by the Impoundment Control Act (title X of Public Law 93-344). Rescission or deferral of loan guarantee authority or direct loan authority should be undertaken under the guidelines currently existing for budget authority.

Reporting of Actual Credit Activity

The executive branch should be directed to report actual activity of new direct loan obligations and new loan guarantee commitments on a periodic basis throughout the fiscal year. Such reporting is a sound management practice and is necessary for proper congressional consideration of Federal credit activities.

Other Recommendations

The subcommittee favors changes in the budgetary treatment of the Federal Financing Bank which would leave its functions intact, but would require attribution of the budget authority and outlays resulting from its operations to the agency initiating the credit transaction. Such attribution is necessary for the budget properly to document Federal activity and to provide accurate information on the use of budget resources. To assure that the debt management purpose of the FFB remains intact, agencies which have the authority to issue securities directly to the public should first offer those securities to the FFB. Direct public borrowing by agencies could have budgetary and economic effects more detrimental than those that currently exist.

Congress should also examine all Federal activities which have been removed from the budget by statute. Off-budget status should be eliminated for any activity that is essentially the same in substance as those activities currently included in the budget.